HCB Financial Corp.

2020

HCB Annual Report

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"Our participation in the Paycheck Protection Program (PPP) contributed to our earnings and our loan growth while bringing meaningful relief to hundreds of our customers."

To our shareholders

From the desk of Mark A. Kolanowski

On behalf of our directors and officers, it is my pleasure to present to you the HCB Financial Corp. 2020 Annual Report. The report reflects positive operating results along with a continued investment in the future of our independently owned and operated community bank. The financial high points include continued improvement in earnings, record loan balances, a growing core deposit base, a strong capital position and exceptional credit quality.

For the twelve months ended December 31, 2020, net income was $2,707,718 or $2.54 per common share. This equates to a 19% improvement over our 2019 earnings of $2,277,745 or $2.14 per share. Total assets at year-end were $395,059,169, a 22% percent increase over the prior year of $324,290,369. Total deposits increased to $333,605,868 and shareholder's equity grew to $35,759,169. Net loans rose 11% to $241,675,448.

We are pleased with all aspects of our business this past year. We were able to successfully navigate through the unprecedented COVID-19 pandemic, achieving record-breaking results along the way. While 2020 presented challenges none of us could have anticipated, we quickly responded in true community bank fashion. Our priority became the safety of our customers and staff, while focusing on getting help to those who needed financial guidance and support. Our participation in the Paycheck Protection Program (PPP) contributed to our earnings and our loan growth while bringing meaningful relief to hundreds of our customers. Our commercial lending team worked tirelessly to deliver $34,054,222 in SBA funds to 340 small businesses, supporting 3,606 employees.

Aside from the Paycheck Protection Program, overall loan demand remained strong throughout the year. Mortgage originations surpassed all expectations, providing a major portion of the 28% increase in non-interest income recorded for the year. Loan quality remains strong, but growth and continued economic uncertainty prompted the need for recording an increased loan loss provision in 2020. Deposit activity was substantial with growth occurring in both retail and commercial core deposit accounts.

Recent investments in technology have allowed us to support our customers through Interactive Teller Machines (ITMs) and Highpoint Connect video banking. These, along with our many online banking services, in addition to in-branch appointment options, provided uninterrupted customer service while keeping customers informed and engaged during the public health crisis. With continued commitment to community, we responded by supporting nonprofit organizations that provide basic needs during this challenging time.

There has been an important change within our leadership team and it is my pleasure to bring that to your attention. Julie Palmatier has been promoted to Vice President, Human Resources Director. Julie joined HCB as Assistant Vice President, Human Resources Director in April 2008. She holds a Bachelor's Degree in Business Administration with an emphasis on Human Resources Administration from Grand Valley State University and a Bachelor of Arts Degree in Educational Development with an emphasis on Human Resources Development from Western Michigan University. Julie has maintained her Senior Professional in Human Resources (SPHR) designation since 2007.

I would be remiss if I did not mention the exceptional way in which our organization responded to the pandemic. While it impacted the way customers chose to bank, it also impacted the way we work. For the first time, we accommodated remote work when that was an appropriate option, following best practice guidelines for workplace safety. The entire staff performed admirably and our commitment to taking care of our customers never wavered.

Our Annual Meeting will be held at 1:00 p.m. on April 21, 2021. The meeting will be held virtually, and the attendance instructions are enclosed. Whether you are able to attend or not, please complete and return the enclosed proxy in advance of the meeting. This will allow us to tally the votes prior to the meeting and proceed without undue delay. Our directors, senior officers and I look forward to having as many of you attend as possible.

Yours truly,

Mark A. Kolanowski
President and Chief Executive Officer

Financial Highlights

AT YEAR-END	2020	2019	% CHANGE
Assets	$395,059	$324,290	22%
Deposits	333,606	265,407	26%
Loans, net	241,675	218,499	11%
Investments	72,912	67,852	7%
Stockholders' Equity	35,759	33,324	7%

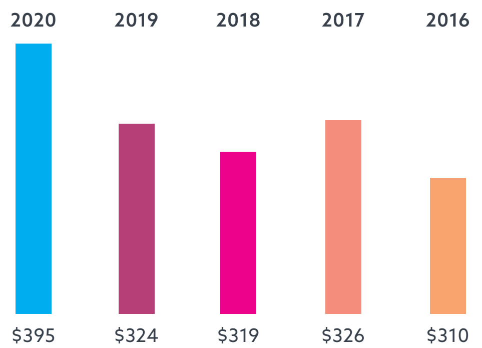
FOR THE YEAR	2020	2019	% CHANGE
Net income	$2,708	$2,278	19%
Return on average assets	0.75%	0.71%	5%
Return on average equity	7.78%	7.03%	11%
Net charge-offs to avg loans	0.00%	0.01%	-131%

PER SHARE			
Dividends per share	$0.85	$0.78	9%
Net income per share	2.54	2.14	19%
Book value at year end	33.55	31.26	7%

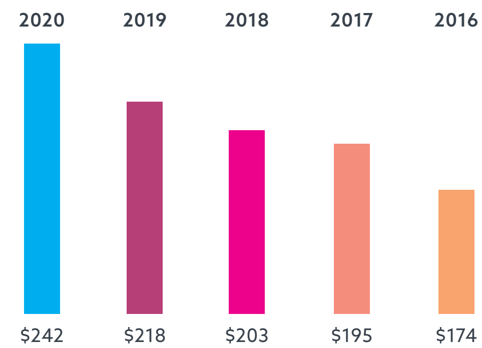
Dollar amounts in thousands, except per-share data

Key Graphs

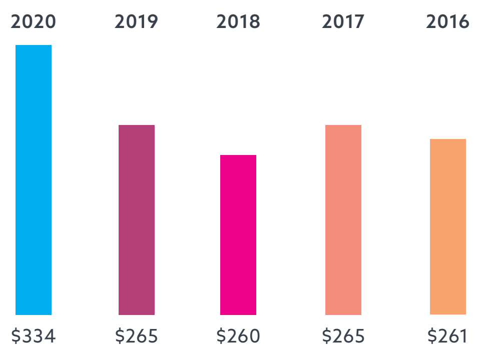
TOTAL ASSETS (MILLIONS)



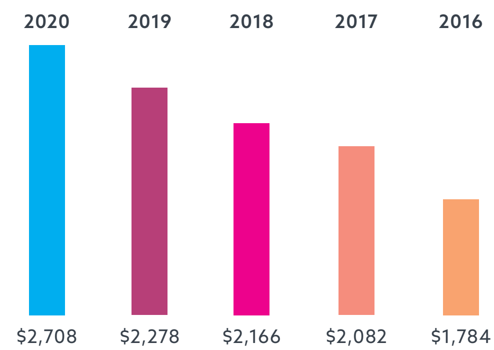
NET LOANS (MILLIONS)



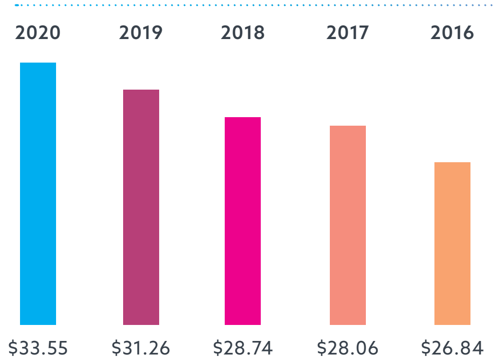
TOTAL DEPOSITS (MILLIONS)



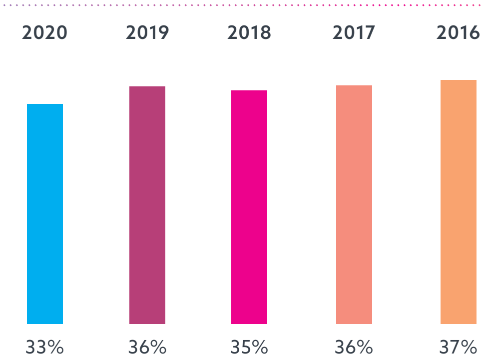
EARNINGS (THOUSANDS)



BOOK VALUE (PER SHARE, IN DOLLARS)

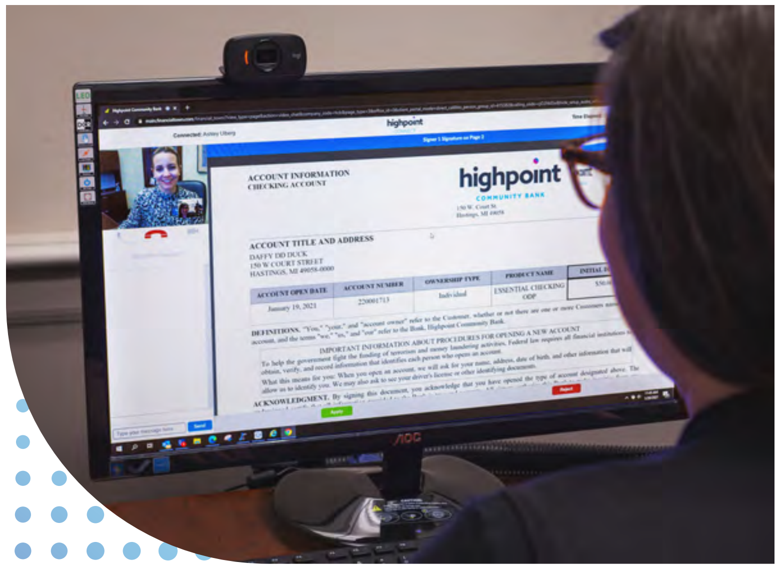


DIVIDEND PAYOUT RATIO



More Ways to Bank with Highpoint Expanded Services

Because we care so much about your banking experience, we've enhanced our everyday services to be even more convenient.



Last year, many businesses were forced to conduct business differently, and financial institutions were no exception. Highpoint Community Bank focused our efforts on serving our customers through our new and expanded services such as 24/7 telephone banking, online banking and Interactive Teller Machines.

We added Highpoint Connect, a new video banking program, which allows our customers to bank directly with a Highpoint representative through video chat.

highpoint
CONNECT

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Independent Member Crowe Global

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Stockholders
HCB Financial Corp.
Hastings, Michigan

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of HCB Financial Corp., which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HCB Financial Corp. as of December 31, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe LLP

Crowe LLP

Grand Rapids, Michigan
February 17, 2021

HCB Financial Corp.
Consolidated Balance Sheets
December 31, 2020 and 2019

	2020	2019
Assets		
Cash and cash equivalents:		
Cash and due from banks	**$ 63,645,439**	$ 18,711,904
	63,645,439	18,711,904
Interest-bearing time deposits in other financial institutions	**9,674,000**	14,587,000
Securities available for sale	**61,656,748**	51,654,300
Securities held to maturity (fair value of $0 in 2020 and $30,836 in 2019)	**-**	30,000
Restricted investment in Federal Home Loan Bank stock	**1,580,800**	1,580,800
Loans, net of allowance of $1,927,917 in 2020 and $1,308,660 in 2019	**241,675,448**	218,498,703
Premises and equipment, net	**8,203,325**	8,649,832
Other real estate owned, net	**-**	-
Bank owned life insurance	**6,617,717**	6,795,500
Accrued interest receivable and other assets	**2,005,692**	3,782,330
Total assets	**$ 395,059,169**	$ 324,290,369
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest-bearing	**$ 70,938,547**	$ 55,313,314
Interest-bearing	**262,667,321**	210,093,295
	333,605,868	265,406,609
Federal Home Loan Bank advances	**24,000,000**	24,000,000
Accrued interest payable and other liabilities	**1,694,140**	1,559,494
Total Liabilities	**359,300,008**	290,966,103
Stockholders' equity:		
Common stock, no par value - 1,500,000 shares authorized; issued and outstanding of 1,066,000 in 2020 and 2019	**1,623,800**	1,623,800
Capital surplus	**2,601,641**	2,601,641
Retained earnings	**30,026,991**	28,225,373
Accumulated other comprehensive income	**1,506,729**	873,452
Total stockholders' equity	**35,759,161**	33,324,266
Total liabilities and stockholders' equity	**$ 395,059,169**	$ 324,290,369

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Income
Years ended December 31, 2020 and 2019

	2020	2019
Interest income		
Loans, including fees	$ 10,909,494	$ 9,683,708
Investment securities:		
Taxable	809,867	993,347
Tax-exempt	397,517	453,097
Federal funds sold and other	310,651	450,519
	12,427,529	11,580,671
Interest expense		
Deposits	763,980	589,763
Federal Home Loan Bank advances and other debt	470,314	566,594
	1,234,294	1,156,357
Net interest income	11,193,235	10,424,314
Provision for loan losses	610,000	65,000
Net interest income after provision for loan losses	10,583,235	10,359,314
Other income		
Service charges and fees	1,482,942	1,611,959
Wealth Management Income	468,577	531,661
Net gain (loss) on securities	2,809	(3,223)
Net gain on sale of loans	761,635	115,278
Earnings from bank owned life insurance	547,275	174,806
Other income	196,759	279,080
	3,459,997	2,709,561
Other expenses		
Salaries and employee benefits	6,126,430	5,702,631
Occupancy and equipment	1,528,019	1,396,402
Data processing	1,958,054	1,858,272
Professional fees	440,478	445,379
FDIC Insurance	55,200	42,331
Other operating expenses	1,066,333	1,261,115
	11,174,514	10,706,130
Income before federal income taxes	2,868,718	2,362,745
Federal income taxes	161,000	85,000
Net income	$ 2,707,718	$ 2,277,745
Basic and Diluted earnings per share	$ 2.54	$ 2.14

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Comprehensive Income
Years ended December 31, 2020 and 2019

	2020	2019
Net income	**$ 2,707,718**	$ 2,277,745
Available-for-sale securities		
Unrealized holding gains arising during the year	**820,476**	1,586,682
Reclassification adjustment for net realized (gains)/losses included in net income (A)	**(2,809)**	3,223
Defined Benefit Plans		
Net unrealized loss on defined benefit plan	**(16,050)**	(24,000)
Other comprehensive income before income tax	**801,617**	1,565,905
Income tax expense related to other comprehensive income (B)	**(168,340)**	(328,840)
Other comprehensive income	**633,277**	1,237,065
Comprehensive Income	**$ 3,340,995**	$ 3,514,810

(A) - Included in net gain (loss) on securities

(B) - Federal Income Tax expense in 2020 and 2019 includes $590 and ($677) related to reclassification adjustments

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Stockholders' Equity
Years ended December 31, 2020 and 2019

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at January 1, 2019	$ 1,623,800	$ 2,601,641	$ 26,779,108	$ (363,613)	$ 30,640,936
Net income	-	-	2,277,745	-	2,277,745
Other comprehensive income	-	-	-	1,237,065	1,237,065
Dividends declared - $.78 per share	-	-	(831,480)	-	(831,480)
Balance at December 31 2019	1,623,800	2,601,641	28,225,373	873,452	33,324,266
Net income	**-**	**-**	**2,707,718**	**-**	**2,707,718**
Other comprehensive income	**-**	**-**	**-**	**633,277**	**633,277**
Dividends declared - $.85 per share	**-**	**-**	**(906,100)**	**-**	**(906,100)**
Balance at December 31 2019	**$ 1,623,800**	**$ 2,601,641**	**$ 30,026,991**	**$ 1,506,729**	**$ 35,759,161**

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Cash Flows
Years ended December 31, 2020 and 2019

	2020	2019
Cash flows from operating activities		
Net income	**$ 2,707,718**	$ 2,277,745
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**610,000**	65,000
Depreciation	**706,933**	602,381
Net amortization of securities	**92,721**	100,117
Earnings on bank owned life insurance, net	**(547,275)**	(174,806)
ESOP shares released	**-**	-
Loans originated for sale	**(19,373,420)**	(4,099,500)
Proceeds from sale of loans	**20,135,055**	4,214,778
Net gain on sales of other real estate	**-**	(37,527)
Net gain on sales of loans	**(761,635)**	(115,278)
Net (gain) loss on securities	**(2,809)**	3,223
Net loss on disposal of assets	**-**	13,572
Proceeds from AMT refund	**1,116,643**	1,116,643
Net change in:		
Accrued interest receivable and other assets	**491,655**	(418,057)
Accrued interest payable and other liabilities	**43,976**	(433,599)
Net cash from operating activities	**5,219,562**	3,114,692
Cash flows for investing activities		
Net change in interest-bearing deposits in other financial institutions	**4,913,000**	4,469,000
Activity in available-for-sale securities:		
Sales	**-**	1,007,380
Maturities, prepayments, calls	**9,133,772**	9,758,157
Purchases	**(18,408,465)**	(2,001,333)
Activity in held-to-maturity securities:		
Maturities, prepayments, calls	**30,000**	1,969,086
Purchases	**-**	(1,913,900)
Loan originations and payments, net	**(23,786,745)**	(2,433,130)
Purchase of mortgage loans	**-**	(13,426,510)
Purchases of premises and equipment, net	**(260,426)**	(1,143,856)
Proceeds from bank owned life insurance	**725,058**	-
Proceeds from sales of other real estate owned	**-**	237,527
Proceeds from sales of assets	**-**	400
Net cash for investing activities	**(27,653,806)**	(3,477,179)
Cash flows from financing activities		
Net change in deposits	**68,199,259**	5,283,802
Proceeds from Federal Home Loan Bank advances	**-**	7,000,000
Repayments of Federal Home Loan Bank advances	**-**	(9,000,000)
Common stock repurchased	**-**	-
Payments to acquire ESOP shares	**-**	-
Cash dividends paid	**(831,480)**	(831,480)
Net cash from financing activities	**67,367,779**	2,452,322
Net change in cash and cash equivalents	**44,933,535**	2,089,835
Cash and cash equivalents at beginning of year	**18,711,904**	16,622,069
Cash and cash equivalents at end of year	**$ 63,645,439**	$ 18,711,904
Supplemental disclosures of cash flow information		
Cash paid for interest	**$ 1,227,620**	$ 1,114,763
Cash paid for income taxes	**200,000**	-
Supplemental non-cash disclosures		
Dividends declared and not paid	**$ 362,440**	$ 287,820

See accompanying notes

HCB Financial Corp.
Notes to Consolidated Financial Statements
December 31, 2020 and 2019

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: HCB Financial Corp. (the Company) is a bank holding company headquartered in Hastings, Michigan. The Company's wholly owned subsidiary, Highpoint Community Bank, (the Bank) operates seven full-service banking offices in and around Barry County. The Bank offers a variety of deposit and lending services.

Principles of Consolidation: The consolidated financial statements include the accounts and operations of HCB Financial Corp. and its wholly owned subsidiaries, Highpoint Community Bank, Citybanc Insurance Services, HCB Real Estate Holdings, LLC and Court Street Financial, Inc. All significant inter-company balances and transactions have been eliminated in consolidation.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through February 17, 2021, which is the date the financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ.

Cash Flows: Cash and cash equivalents include cash, deposits with other financial institutions and federal funds sold. Net cash flows are reported for customer loan and deposit transactions and for interest bearing time deposits with other financial institutions.

Cash and Cash Equivalents: The Company maintains deposit accounts with other financial institutions which generally exceed federally insured limits or are uninsured.

Interest-Bearing Time Deposits in other Financial Institutions: Interest-bearing time deposits in other financial institutions consist of fully insured certificates of deposits with $3,225,000 maturing within 1 year, $5,705,000 maturing within 2-5 years and $744,000 maturing within 6-10 years.

Restricted Investments: The Bank is a member of the Federal Home Loan Bank (FHLB) System and is required to invest in capital stock of the FHLB of Indianapolis. The amount of the required investment is determined and adjusted periodically by the FHLB.

Securities: Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts are amortized on the level yield method. Gains and losses on sales are based on the amortized cost of the security sold. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment (“OTTI”) on at least an annual basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for loan losses. The Bank's loans are generally secured by specific items of collateral including real property, consumer assets, and business assets.

Interest income is reported on the interest method. Interest income on loans is generally discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received, for loans placed on nonaccrual, is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans held for sale are reported at the lower of cost or market, on an aggregate basis. Mortgage loans held for sale are generally sold with servicing rights retained; the carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management’s judgment, should be charged off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Commercial and commercial real estate loans are individually evaluated for impairment if outstanding loans to a borrower are, in aggregate, over $150,000 and the risk rating assigned to a loan is a non-pass rating. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net at the present value of estimated future cash flows using the loan’s existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Troubled debt restructurings are also considered impaired and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The general component of the Allowance for Loan Losses covers non-impaired loans and large groups of homogeneous loans and is based on historical loss experience, over the last three years, adjusted for current risk factors. The following portfolio segments have been identified and the risk factors listed below are considered in determining the allowance for loan loss:

Residential real estate loans are evaluated for impairment using various economic indicators. Environmental factors that may impact collateral value on residential real estate loans include data on average local home sales, national and local economic conditions, and local employment rates. These factors are used to calculate an adjustment for current economic conditions. Other residential real estate loans with additional risk factors are loans where the payment is more than 30 days past due.

Commercial loans are evaluated for impairment using the following risk classification codes assigned to commercial credits internally:

- Risk Ratings 1-5 are considered to be within an acceptable risk tolerance to the bank.
- Risk Rating 6 is considered special mention. Loans in this category are included on the watch list, have identifiable weaknesses, and are reviewed quarterly for impairment. Special Mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.
- Risk Rating 7 is considered substandard. Loans in this category are considered very high risk, are included on the watch list, have well-defined weaknesses, normal repayment is in jeopardy, and are reviewed quarterly for impairment.
- Risk Rating 8 is considered impaired non-accrual. Loans in this category have all Substandard characteristics plus the loans are in Non-accrual status. These loans have significant weaknesses making full collection of interest unlikely.
- Risk Rating 9 is considered doubtful. Loans in this category possess all Substandard Non-accrual characteristics and have significant weaknesses making full collection through payment or liquidation questionable and improbable.
- Risk Rating 10 is considered loss. Loans are charged-off in a timely manner, as collection is highly unlikely.

These risk codes are reviewed and adjusted as appropriate in several circumstances. A formal loan review process is conducted on loans above various dollar thresholds based on the type of collateral securing the credit. The loan reviewer will either affirm that the risk rating is appropriate or recommend a change. Risk codes are also adjusted upon loan renewals, additional requests, and upon receipt of knowledge that an event has caused a change in apparent risk of an individual credit. In addition, business loan charge-offs are evaluated annually to assess the likelihood of deteriorating to charge-off before the determination that an allocated reserve is required. That additional loss factor is applied to non-impaired loans with a 5 and 6 rating. Any loans that are not individually evaluated for impairment are assigned an additional risk factor if they become past due by 30 days or more.

Consumer loans are both secured and unsecured and an additional risk factor is applied to loans that are past due by 30 days or more.

Bank-Owned Life Insurance: The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contracts at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts that are probable at settlement.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Servicing Rights: Servicing rights represent the fair value of retained servicing rights on loans sold. Servicing assets are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on the fair value of the assets, using groupings of the underlying loans as to interest rates and then, secondarily, as to prepayment characteristics. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Any impairment is reported as a valuation allowance to the extent that fair value is less than the capitalized amount.

Servicing fee income, which is reported on the income statement as other income, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees total $115,000 and $125,000 for the years ended December 31, 2020 and 2019, respectively. Late fees and ancillary fees related to loan servicing are not material.

Premises and Equipment: Land is stated at cost. Premises and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed principally using the straight-line method over the estimated lives of the related assets. Expenditures for normal repair and maintenance are charged to expenses as incurred.

Other Real Estate Owned: Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at the fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

Long-Term Assets: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Post Retirement Benefit: The Bank sponsors a post retirement benefit plan that provides medical and life insurance benefits to eligible retirees, who retired prior to 2004, for life. At year-end 2020, the plan provided benefits to 9 participants. At year-end 2020 and 2019, the accrued benefit obligation recognized in the consolidated balance sheet and the unrecognized actuarial gain were $108,000 and $0 and $175,000 and $16,000, respectively. Additional disclosures related to the post retirement health care plan are not material to the financial statements.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax basis of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Earnings Per Share: Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period, which were 1,066,000 for both 2020 and 2019. There were no potentially dilutive common stock equivalents for 2020 or 2019.

Off-Balance Sheet Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale and changes in the funded status of the Company's post retirement benefit plans, which are also recognized as separate components of equity.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are such matters that will have a material effect on the financial statements.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to shareholders.

Revenue Recognition: ASC Topic 606, Revenue from Contracts with Customers provides the guidance used to recognize revenue from contracts with customers for transfers of goods or services and transfers of non-financial assets, unless those contracts are within the scope of other guidance. The Company's principal revenue streams that are within the scope of ASC 606 include service charges and fees and trust income. These revenues are generally recognized immediately upon the completion of the service or over time as services are performed. Any services performed over time generally require that the Company renders services each period, for example monthly, therefore the Company measures progress in completing these services based upon the passage of time.

Reclassifications: Certain items in the prior year financial statements were reclassified to conform to the current presentation.

NOTE 2 - SECURITIES

The fair value of available-for-sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income were as follows:

Available-for-sale

2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government and federal agency	$ 9,792,971	$ 186,076	$ 10,144	$ 9,968,903
State and municipal	33,816,881	1,482,166	-	35,299,047
Mortgage-backed, residential	13,149,870	184,445	3,568	13,330,747
Corporate	2,989,774	68,277	-	3,058,051
Total	$ 59,749,496	$ 1,920,964	$ 13,712	$ 61,656,748
2019				
U.S. Government and federal agency	$ 5,538,564	$ 99,705	$ -	$ 5,638,269
State and municipal	34,038,901	968,544	31,883	34,975,562
Mortgage-backed, residential	7,003,931	39,145	16,932	7,026,144
Corporate	3,983,319	31,027	21	4,014,325
Total	$ 50,564,715	$ 1,138,421	$ 48,836	$ 51,654,300

The carrying amount, unrecognized gains and losses, and fair value of securities held-to-maturity were as follows:

Held-to-maturity

2020	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
State and municipal	$ -	$ -	$ -	$ -
2019				
State and municipal	$ 30,000	$ 836	$ -	$ 30,836

The fair value of debt securities and carrying amount, if different, at year-end 2020 by contractual maturity were as follows: Securities not due at a single maturity date, primarily consisting of mortgage-backed securities, are shown separately.

	Held-to-maturity		Available-for-sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ -	$ -	$ 7,327,809	$ 7,388,834
Due after one through five years	-	-	29,758,159	30,964,303
Due after five through ten years	-	-	9,362,658	9,821,864
Due after ten years	-	-	151,000	151,000
Mortgage-backed, residential	-	-	13,149,870	13,330,747
	$ -	$ -	$ 59,749,496	$ 61,656,748

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 2 - SECURITIES (Continued)

Securities pledged at year-end 2020 and 2019 had a carrying amount of $3,508,000 and $3,863,000 respectively, and were pledged to secure public deposits and other purposes as required or permitted by law.

Securities with unrealized losses at year-end 2020 and 2019, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2020						
U.S. Govt. and federal agency	**$ 3,989,856**	**$ 10,144**	**$ -**	**$ -**	**$ 3,989,856**	**$ 10,144**
State and municipal	**-**	**-**	**-**	**-**	**-**	**-**
Mortgage-backed, residential	**2,010,156**	**3,568**	**-**	**-**	**2,010,156**	**3,568**
Corporate	**-**	**-**	**-**	**-**	**-**	**-**
	$ 6,000,012	**$ 13,712**	**$ -**	**$ -**	**$ 6,000,012**	**$ 13,712**
2019						
U.S. Govt. and federal agency	$ -	$ -	$ -	$ -	$ -	$ -
State and municipal	918,415	5,585	4,847,082	26,298	5,765,497	31,883
Mortgage-backed, residential	2,202,185	15,344	387,968	1,588	2,590,153	16,932
Corporate	-	-	499,897	21	499,897	21
	$ 3,120,600	$ 20,929	$ 5,734,947	$ 27,907	$ 8,855,547	$ 48,836

Unrealized losses have not been recognized into income because the securities are of high credit quality, management does not intend to sell and it is not likely that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in market interest rates. The fair value is expected to recover as the securities approach their maturity date and/or market rates decline.

Sales of available-for-sale securities were as follows:

	2020	2019
Proceeds	**$ -**	$ 1,007,380
Gross gains	**-**	-
Gross losses	**-**	(3,223)

During 2020, a security was called resulting in a gain of $2,809.

NOTE 3 - LOANS

Loans at year-end were as follows:

	2020	2019
Residential real estate:		
Residential mortgages	**$ 83,849,476**	$ 79,467,120
Home equity loans	**8,777,213**	12,220,093
Commercial:		
Real estate secured	**58,991,447**	56,888,099
Non-real estate secured	**34,374,183**	20,840,297
Municipal loans	**47,240,897**	38,857,352
Consumer	**10,370,149**	11,534,402
Subtotal	**243,603,365**	219,807,363
Allowance for loan losses	**(1,927,917)**	(1,308,660)
	$ 241,675,448	$ 218,498,703

Mortgage loans serviced for others are not reported as assets. Such loans aggregated to $49,148,000 and $46,365,000 at year-end 2020 and 2019, respectively. Mortgage loans originated for sale, but not yet delivered are included in residential mortgages and were $911,000 and $0 at year-end 2020 and 2019. Capitalized mortgage servicing rights were $351,000 and $286,000 at year-end 2020 and 2019, respectively.

Certain directors and executive officers of the Company, including their associates, were loan customers of the Bank during 2020 and 2019. The outstanding loan balances for these persons at December 31, 2020 and 2019 amounted to $1,607,000 and $1,852,000, respectively. During 2020, new loans to these persons amounted to $867,000 and payments amounted to $1,112,000, compared to new loans of $457,000 and payments of $428,000 during 2019.

Activity in the allowance for loan losses for 2020 and 2019, by portfolio segment, was as follows:

December 31, 2020	**Residential Real Estate**	**Commercial**	**Consumer**	**Total**
Allowance for loan losses:				
Beginning balance	**$ 376,944**	**$ 834,135**	**$ 97,581**	**$ 1,308,660**
Provision for loan losses	**229,881**	**409,573**	**(29,454)**	**610,000**
Loans charged-off	**-**	**-**	**(2,712)**	**(2,712)**
Recoveries	**100**	**-**	**11,869**	**11,969**
Ending balance:	**$ 606,925**	**$ 1,243,708**	**$ 77,284**	**$ 1,927,917**
December 31, 2019				
Allowance for loan losses:				
Beginning balance	$ 383,013	$ 773,114	$ 112,995	$ 1,269,122
Provision for loan losses	(6,069)	68,865	2,204	65,000
Loans charged-off	-	(7,994)	(24,828)	(32,822)
Recoveries	-	150	7,210	7,360
Ending balance:	$ 376,944	$ 834,135	$ 97,581	$ 1,308,660

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 3 - LOANS (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2020 and 2019:

December 31, 2020	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:				
Individually evaluated for impairment	$ 247,355	$ 167,645	$ 36,800	$ 451,800
Collectively evaluated for impairment	359,570	1,076,063	40,484	1,476,117
Ending allowance balance attributable to loans:	$ 606,925	$ 1,243,708	$ 77,284	$ 1,927,917
Loan balances:				
Individually evaluated for impairment	$ 594,811	$ 261,953	$ 41,009	$ 897,773
Collectively evaluated for impairment	92,031,878	140,344,574	10,329,140	242,705,592
Total ending loan balances:	$ 92,626,689	$ 140,606,527	$ 10,370,149	$ 243,603,365
December 31, 2019				
Allowance for loan losses:				
Individually evaluated for impairment	$ 252,135	$ 172,865	$ 49,795	$ 474,795
Collectively evaluated for impairment	124,809	661,270	47,786	833,865
Ending allowance balance attributable to loans:	$ 376,944	$ 834,135	$ 97,581	$ 1,308,660
Loan balances:				
Individually evaluated for impairment	$ 723,005	$ 284,010	$ 53,550	$ 1,060,565
Collectively evaluated for impairment	90,964,208	116,301,738	11,480,852	218,746,798
Total ending loan balances:	$ 91,687,213	$ 116,585,748	$ 11,534,402	$ 219,807,363

The following table presents information related to impaired loans by class of loans as of and for the year ended December 31, 2020 and 2019:

December 31, 2020

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:						
Residential real estate						
Residential mortgages	$ 55,088	$ 55,088	$ -	$ 55,524	$ 3,546	$ -
Home equity loans	-	-	-	-	-	-
Commercial						
Real estate secured	-	-	-	-	-	-
Non-real estate secured	-	-	-	-	-	-
Consumer	4,209	4,209	-	5,166	414	8
Subtotal	59,297	59,297	-	60,690	3,960	8
With related allowance recorded:						
Residential real estate						
Residential mortgages	539,723	539,723	247,355	546,301	25,753	2,155
Home equity loans	-	-	-	-	-	-
Commercial						
Real estate secured	261,953	261,953	167,645	272,889	14,094	800
Non-real estate secured	-	-	-	-	-	-
Consumer	36,800	36,800	36,800	41,853	272	6
Subtotal	838,476	838,476	451,800	861,043	40,119	2,961
Total	$ 897,773	$ 897,773	$ 451,800	$ 921,733	$ 44,079	$ 2,969

NOTE 3 - LOANS (Continued)

December 31, 2019	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:						
Residential real estate						
Residential mortgages	$ 107,824	$ 107,824	$ -	$ 108,639	$ 6,207	$ 6,351
Home equity loans	81,625	81,625	-	83,081	4,014	3,759
Commercial						
Real estate secured	-	-	-	-	-	-
Non-real estate secured	-	-	-	-	-	-
Consumer	3,612	3,612	-	4,564	25	24
Subtotal	193,061	193,061	-	196,284	10,246	10,134
With related allowance recorded:						
Residential real estate						
Residential mortgages	533,556	533,556	252,135	538,838	25,269	25,594
Home equity loans	-	-	-	-	-	-
Commercial						
Real estate secured	284,010	284,010	172,865	293,505	17,346	17,227
Non-real estate secured	-	-	-	-	-	-
Consumer	49,938	49,938	49,795	45,992	341	340
Subtotal	867,504	867,504	474,795	878,335	42,956	43,161
Total	$ 1,060,565	$ 1,060,565	$ 474,795	$ 1,074,619	$ 53,202	$ 53,295

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net due to immateriality. For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs.

Non-accrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following tables present the recorded investment in non-accrual and loans past due over 90 days still on accrual by class of loans as of December 31, 2020 and December 31, 2019:

	2020		2019	
	Non-Accrual	Loans Past Due Over 90 Days Still Accruing	Non-Accrual	Loans Past Due Over 90 Days Still Accruing
Residential real estate				
Residential mortgages	$ -	$ -	$ -	$ -
Home equity loans	-	-	-	-
Commercial				
Real estate secured	-	-	-	-
Non-real estate secured	-	-	-	-
Municipal loans	-	-	-	-
Consumer	14,553	-	-	-
	$ 14,553	$ -	$ -	$ -

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 3 - LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans by class of loans as of December 31, 2020 and 2019:

December 31, 2020	30 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due
Residential real estate				
Residential mortgages	**$ 105,958**	**$ -**	**$ 105,958**	**$ 83,743,518**
Home equity loans	**10,782**	**-**	**10,782**	**8,766,431**
Commercial				
Real estate secured	**-**	**-**	**-**	**58,991,447**
Non-real estate secured	**-**	**-**	**-**	**34,374,183**
Municipal loans	**-**	**-**	**-**	**47,240,897**
Consumer	**796**	**14,553**	**15,349**	**10,354,800**
	$ 117,536	**$ 14,553**	**$ 132,089**	**$ 243,471,276**
December 31, 2019				
Residential real estate				
Residential mortgages	$ 340,770	$ -	$ 340,770	$ 79,126,350
Home equity loans	-	-	-	12,220,093
Commercial				
Real estate secured	17,265	-	17,265	56,870,834
Non-real estate secured	-	-	-	20,840,297
Municipal loans	-	-	-	38,857,352
Consumer	37,266	-	37,266	11,497,136
	$ 395,301	$ -	$ 395,301	$ 219,412,062

Troubled Debt Restructurings:

The Company has allocated $452,000 and $475,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2020 and 2019. Of these reserves, $408,000 and $420,000 represent reserves on collateral dependent troubled debt restructures. The outstanding balance of such loans was $635,000 and $679,000 at year-end 2020 and 2019. The Company committed to lending no additional amounts, as of December 31, 2020 and 2019 respectively, to customers with outstanding loans that are classified as troubled debt restructurings.

The modifications of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the market rate for new debt with similar risk, capitalization of interest due or a nominal principal advance to enhance collectability of the debt.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 12 months to 30 years. Modifications involving an extension of the maturity date were for periods ranging from 12 months to 30 years.

During 2020, 1 consumer loan was modified. The pre-modification outstanding recorded investment on this modified loans was $3,000 and the post-modification outstanding recorded investment was $3,000. This troubled debt restructuring increased the allowance for loan losses by $0 and resulted in a charge-off of $0 during the year ending December 31, 2020. During 2019 there were no troubled debt restructurings.

There were no troubled debt restructurings in payment default within twelve months following the modification during the year ending December 31, 2020 or December 31, 2019. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

NOTE 3 - LOANS (Continued)

Coronavirus Pandemic Response:

During 2020, the coronavirus outbreak resulted in widespread business and social disruption. In March 2020, this outbreak was declared a National Emergency by the United States federal government. Actions during 2020 included restrictions on business operations and even the closure of certain businesses.

The response to this matter and the economic disruption it had on our customers and their businesses had significant impact on us and our operations in 2020, in particular, on our loan portfolios and the provision for loan losses, including:

- Increased provisions for loan losses and an increase in our allowance for loan losses at year-end 2020 as we expect credit losses have been incurred that have not yet been identified.
- The U.S. Treasury established a Paycheck Protection Loan Program (PPP) working through the Small Business Administration (SBA). Through this program, SBA guaranteed loans were extended to qualifying customers which, if used in accordance with PPP program requirements, will be forgiven and repaid by the SBA. During 2020, we originated approximately $34 million of PPP loans. At year-end 2020, approximately $18 million remain outstanding with the balance having been forgiven and repaid. These loans are included in non real-estate secured commercial loans in our loan footnote.
- In March 2020, banking regulatory agencies issued guidance which provided that short-term loan modifications granted to customers impacted by the Pandemic were not to be considered as Troubled Debt Restructurings (TDRs), as defined previously, nor designated as impaired. Also, in March 2020, the U.S. Congress passed the Coronavirus Aid, Relief and Economic Security (CARES) Act which provided a statutory suspension of Generally Accepted Accounting Principles (GAAP) as it relates to the application of TDR accounting. This suspension was to remain available until the earlier of 60 days after the national emergency declared in March was terminated or December 31, 2020. This CARES Act relief has now been extended until January 1, 2022. Pursuant to this relief, during 2020, the Bank modified the terms of customers' loans including providing for a deferral of payments and/or providing interest only payments. These loan modifications were not considered to be TDRs or impaired following that guidance. During 2020, the Bank granted loan modifications to 115 customers whose principal balances were approximately $12 million at year-end. At year-end 2020, 4 of these loans with an outstanding balance of approximately $2 million remained in deferred status.

The longer-term impact to our results of operations and financial position cannot be reasonably estimated at this time. Numerous government actions have been implemented to assist small businesses and more are being discussed. The extent of the full economic impact of the coronavirus will depend on future developments, which are highly uncertain and cannot be predicted, including new information that may emerge concerning the severity of the virus's spread, the effectiveness of vaccines and vaccination programs and the actions required to contain it or treat its impacts.

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 3 - LOANS (Continued)

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes credit relationships with an outstanding balance greater than $150,000 and non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed annually, at renewals, and when new information on a credit is learned. The Company uses the following definitions for risk ratings:

Special Mention: Loans classified as special mention are included on the watch list, have identifiable weaknesses and are reviewed quarterly for impairment. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. Not rated loans that are past due 30-89 days are also included in this category.

Substandard: Loans classified as substandard are considered very high risk, included on watch list, have well-defined weaknesses, normal repayment is in jeopardy and they are reviewed quarterly for impairment. Not rated loans that are more than 89 days past due are included in this category.

Impaired Non-Accrual: Loans classified as impaired non-accrual are very high risk and are in non-accrual status. These loans have significant weaknesses making full collection of interest unlikely.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as impaired non-accrual, plus significant weaknesses making full collection through payment or liquidation questionable and improbable. The bank had no doubtful loans in 2020 and 2019.

Loans not meeting the criteria above, that are analyzed individually as part of the above described process, are considered to be pass rated loans. Municipal loans are primarily short-moderate term loans to municipalities related to maintenance or improvement projects that are funded by approved special tax assessments. The Company reviews updated financial information on long-term issues periodically. Groups of homogeneous loans and municipal loans are not rated and are listed as pass.

Based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

December 31, 2020	**Pass**	**Special Mention**	**Substandard**	**Impaired Non-Accrual**	**Total**
Residential real estate					
Residential mortgages	**$ 83,226,067**	**$ 623,409**	**$ -**	**$ -**	**$ 83,849,476**
Home equity loans	**8,689,071**	**88,142**	**-**	**-**	**8,777,213**
Commercial					
Real estate secured	**55,447,353**	**3,282,141**	**261,953**	**-**	**58,991,447**
Non-real estate secured	**33,750,707**	**595,505**	**27,971**	**-**	**34,374,183**
Municipal loans	**47,240,897**	**-**	**-**	**-**	**47,240,897**
Consumer	**10,313,792**	**41,804**	**-**	**14,553**	**10,370,149**
Total	**$ 238,667,887**	**$ 4,631,001**	**$ 289,924**	**$ 14,553**	**$ 243,603,365**

December 31, 2019	**Pass**	**Special Mention**	**Substandard**	**Impaired Non-Accrual**	**Total**
Residential real estate					
Residential mortgages	$ 78,484,970	$ 982,150	$ -	$ -	$ 79,467,120
Home equity loans	12,138,468	81,625	-	-	12,220,093
Commercial					
Real estate secured	55,926,935	677,154	284,010	-	56,888,099
Non-real estate secured	20,800,502	-	39,795	-	20,840,297
Municipal loans	38,857,352	-	-	-	38,857,352
Consumer	11,443,586	90,816	-	-	11,534,402
Total	$ 217,651,813	$ 1,831,745	$ 323,805	$ -	$ 219,807,363

NOTE 4 - PREMISES AND EQUIPMENT

Premises and equipment are summarized as follows:

	2020	2019
Land	**$ 1,785,136**	$ 1,785,136
Buildings	**9,979,099**	9,702,736
Furniture and equipment	**4,160,526**	4,208,237
	15,924,761	15,696,109
Less: Accumulated depreciation	**(7,721,436)**	(7,046,277)
	$ 8,203,325	$ 8,649,832

NOTE 5 - DEPOSITS

Time deposits of $250,000 or more were $4,535,000 and $4,334,000 at year-end 2020 and 2019, respectively. Scheduled maturities of all time deposits for the next five years and thereafter are as follows:

2021	$ 25,079,525
2022	2,150,742
2023	1,470,213
2024	404,752
2025	461,203
Thereafter	70,663

The Company held deposits of approximately $3,195,000 and $2,487,000 for related parties at December 31, 2020 and 2019, respectively.

NOTE 6 - FEDERAL HOME LOAN BANK ADVANCES

Advances from the Federal Home Loan Bank were $24,000,000 and $24,000,000 at year-end 2020 and 2019, respectively. The weighted average fixed interest rate of outstanding advances was 1.92% and 1.92% at year-end 2020 and 2019, respectively.

Advances are payable at maturity dates, or prior with penalty for prepayment. The advances were collateralized by $68,297,000 and $60,368,000 of first mortgage loans under a blanket lien arrangement at year-end 2020 and 2019, respectively.

Scheduled maturities and required payments over the next five years and thereafter:

2021	$ -
2022	5,000,000
2023	-
2024	-
2025	-
Thereafter	19,000,000

$19,000,000 of advances are “Putable” advances which provide the Federal Home Loan Bank (“FHLB”) the option to convert the entire advance to an Adjustable Rate Advance at certain dates beginning in 2021. The advances are fixed rate advances until that time. If the FHLB exercises its option, the Company may pay off the advance without penalty. These advances have final maturity dates in 2026, 2028 and 2029.

The Company's Federal Home Loan Bank Overdraft Line of Credit had a balance of $0 at year-end 2020 and 2019.

NOTE 7 - RETIREMENT PLAN

The Bank sponsors a 401(k) savings plan that allows eligible employees to contribute a percentage of their annual compensation. The Bank matches a portion of the participant's contribution, up to plan-specified maximums. The Bank contributed $78,000 and $75,000 to the plan during 2020 and 2019, respectively. The Bank may also elect to make a profit-sharing contribution to the Plan.

Additionally, retirement benefits are provided to substantially all employees under a discretionary profit-sharing and employee stock ownership plan (ESOP). The Bank recognized expense of $265,000 and $210,000 during 2020 and 2019, respectively, related to the profit-sharing plan, which includes contributions to the ESOP of $165,000 and $130,000 in 2020 and 2019, respectively.

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 8 - FEDERAL INCOME TAXES

The provision for income taxes is summarized as follows:

	Year ended December 31 2020	2019
Current	$ 398,000	$ (59,000)
Deferred	(237,000)	144,000
	$ 161,000	$ 85,000

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Bank's deferred tax assets and liabilities are as follows:

	December 31 2020	2019
Deferred income tax assets:		
Allowance for loan losses in excess of deductible amounts	$ 340,000	$ 212,000
Post retirement benefits	23,000	37,000
Accrued liabilities	130,000	70,000
Deferred Loan Fees	79,000	6,000
Net operating loss carryforward	-	32,000
Other	2,000	7,000
	574,000	364,000
Deferred income tax liabilities:		
Prepaid expenses	(56,000)	(51,000)
Book-tax basis differences on property and equipment	(382,000)	(436,000)
Unrealized gains on securities	(401,000)	(229,000)
Mortgage servicing rights	(74,000)	(60,000)
Other	(23,000)	(19,000)
	(936,000)	(795,000)
Net deferred income tax assets/(liabilities)	$ (362,000)	$ (431,000)

At December 31, 2020 and December 31, 2019 there were no unrecognized tax benefits recorded. The Bank does not expect the amount of unrecognized tax benefits to significantly change within the next twelve months. There were no interest or penalties recorded during 2020 or 2019. The Company is subject to U.S. federal income tax and is no longer subject to examination by taxing authorities for years before 2017.

At December 31, 2019, the Company has $1,117,000 of alternative minimum tax credit (AMTC) carryforwards which were included in accrued interest receivable and other assets on the consolidated balance sheet. During 2020, the Company received a full refund of their AMTC carryforwards. In 2019, the Company generated a net operating loss of $152,000, which had an unlimited carryforward period. The Company was able to fully utilize this carryforward in 2020.

A reconciliation of the difference between federal income taxes and the amount computed by applying the statutory rate are as follows:

	Year ended December 31 2020	2019
Taxes at statutory rate	$ 602,000	$ 496,000
Effect of tax-exempt interest	(329,000)	(312,000)
Effect of BOLI income	(115,000)	(37,000)
Other	3,000	(62,000)
	$ 161,000	$ 85,000

NOTE 9 - LOAM COMMITMENTS AND STANDBY LETTERS OF CREDIT

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

At December 31, 2020 and 2019, the Bank had commitments to fund loans to customers and available unused lines of credit of $19,195,000 and $15,625,000, respectively. Commitments under outstanding standby letters of credit amounted to $728,000 and $728,000 at December 31, 2020 and 2019, respectively.

NOTE 10 – REGULATORY MATTERS

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became fully effective for the Bank on January 1, 2019. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. The table below presents capital adequacy information including the 2.50% capital conservation buffer. Management believes, as of December 31, 2020 and December 31 2019, the Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2020 and 2019, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Actual and required capital amounts (000's omitted) and ratios at year-end are presented below:

	Actual		Required For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
2020						
Total capital to risk-weighted assets:	**$ 36,154**	**18.54%**	**$ 20,472**	**10.50%**	**$ 19,497**	**10.00%**
Tier 1 (Core) Capital to risk-weighted assets:	**34,226**	**17.55**	**16,572**	**8.50**	**15,598**	**8.00**
Common Tier 1 to risk-weighted assets (CET1):	**34,226**	**17.55**	**13,648**	**7.00**	**12,673**	**6.50**
Tier 1 (Core) Capital to average assets:	**34,226**	**8.81**	**25,242**	**4.00**	**19,417**	**5.00**
2019						
Total capital to risk-weighted assets:	$ 33,745	17.46%	$ 20,298	10.50%	$ 19,332	10.00%
Tier 1 (Core) Capital to risk-weighted assets:	32,436	16.78	16,432	8.50	15,465	8.00
Common Tier 1 to risk-weighted assets (CET1):	32,436	16.78	13,532	7.00	12,566	6.50
Tier 1 (Core) Capital to average assets:	32,436	9.94	21,203	4.00	16,310	5.00

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 11 - FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

> **Level 1** – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
>
> **Level 2** – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
>
> **Level 3** – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Securities: The fair value for securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and Treasury curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations. The Company had no securities designated as Level 3 securities at year-end 2020 and 2019.

Impaired Loans: The fair value of collateral dependent impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate valuations. These valuations may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Other Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate valuations which are updated no less frequently than annually. These valuations may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Valuations for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties), certified residential appraisers, state licensed appraisers or licensed realtors (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, an administrator level or higher reviews the assumptions and approaches utilized in the valuation as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Company compares the actual selling price of collateral that has been sold to the most recent valuation to determine what additional adjustment should be made to the valuation to arrive at fair value. The most recent analysis performed indicated that a discount of 20% should be applied.

NOTE 11 - FAIR VALUE (Continued)

Assets and liabilities measured at fair value on a recurring basis are summarized below:

Fair Value Measurements at December 31 using:

2020	Carrying Value	Level 1	Level 2	Level 3
U.S. Government and federal agency	$ 9,968,903	$ -	$ 9,968,903	$ -
State and municipal	35,299,047	-	35,299,047	-
Mortgage-backed, residential	13,330,747	-	13,330,747	-
Corporate	3,058,051	-	3,058,051	-
Asset-backed securities	-	-	-	-
Available-for-sale securities	$ 61,656,748	$ -	$ 61,656,748	$ -

2019	Carrying Value	Level 1	Level 2	Level 3
U.S. Government and federal agency	$ 5,638,269	$ -	$ 5,638,269	$ -
State and municipal	34,975,562	-	34,975,562	-
Mortgage-backed, residential	7,026,144	-	7,026,144	-
Corporate	4,014,325	-	4,014,325	-
Asset-backed securities	-	-	-	-
Available-for-sale securities	$ 51,654,300	$ -	$ 51,654,300	$ -

Assets measured at fair value on a non-recurring basis are summarized below:

December 31, 2020	Level 1	Level 2	Level 3
Impaired Loans			
Residential mortgages	$ -	$ -	$ 132,262
Commercial			
Real estate secured	-	-	94,308
Non-real estate secured	-	-	-
Total impaired loans	-	-	226,570
Other Real Estate Owned			
Commercial real estate	-	-	-
Total impaired loans / other real estate owned	$ -	$ -	$ 226,570

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 11 - FAIR VALUE (Continued)

December 31, 2019	Level 1	Level 2	Level 3
Impaired Loans			
Residential real estate			
Residential mortgages	$ -	$ -	$ 154,779
Commercial			
Real estate secured	-	-	104,388
Non-real estate secured	-	-	-
Total impaired loans	-	-	259,167
Other Real Estate Owned			
Commercial real estate	-	-	-
Total impaired loans / other real estate owned	$ -	$ -	$ 259,167

As discussed previously, the fair values of impaired loans carried at fair value are determined by third party appraisals. Management makes adjustments to these appraised values based on the age of the appraisal. Quantitative information about level 3 fair value measurements is presented if there are large or complex classes of financial instruments measured at fair value on a non-recurring basis. No such information is deemed significant for 2020 or 2019.

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, a level 3 value, had a carrying amount of $635,000 prior to a valuation allowance of $408,000 at December 31, 2020, resulting in a reduction of allocation for loan losses of $12,000 for the year ending December 31, 2020. At December 31, 2019, impaired loans had a carrying amount of $679,000, prior to a valuation allowance of $420,000, resulting in a reduction of allocation for loan losses of $41,000 for the year ending December 31, 2019.

NOTE 11 - FAIR VALUE (Continued)

The methods and assumptions, not previously presented, used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, interest-bearing deposits, short-term borrowings and accrued interest receivable and payable. The methods for determining the fair values for securities were described previously. For fixed and variable rate loans, fair value is based upon the exit price notion where projected cash flows are discounted using interest rates and credit adjustments from a market participants' perspective. For interest-bearing deposits and for deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance sheet items is not considered material.

The carrying amounts, estimated fair values of financial instruments and fair value level are summarized as follows:

		2020		2019	
	Fair Value Level	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:					
Cash and cash equivalents	1	**$ 63,645,439**	**$ 63,645,000**	$ 18,711,904	$ 18,712,000
Interest-bearing deposits	2	**9,674,000**	**10,083,000**	14,587,000	14,732,000
Securities - held-to-maturity	2	**-**	**-**	30,000	31,000
Securities - available-for-sale	2	**61,656,748**	**61,657,000**	51,654,300	51,654,000
Federal Home Loan Bank stock	N/A	**1,580,800**	**NA**	1,580,800	NA
Loans, net	3	**241,675,448**	**243,063,000**	218,498,703	217,538,000
Accrued interest receivable	2	**1,478,010**	**1,478,000**	1,357,230	1,357,000
Liabilities:					
Deposits (Non Time Deposits)	1	**$ 303,968,770**	**$ 303,969,000**	$ 241,063,179	$ 241,063,000
Time Deposits	2	**29,637,098**	**29,750,000**	24,343,430	23,980,000
Federal Home Loan Bank advances	2	**24,000,000**	**25,479,000**	24,000,000	23,834,000
Accrued interest payable	2	**94,955**	**95,000**	88,281	88,000

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Directors & Officers

Front: Joan M. Heffelbower, Archie A. Warner, Barbara L. Hunt
Back: W. Scott McKeown, Brian N. Calley, Matthew R. Garber, Mark A. Kolanowski, Joseph J. Babiak, James H. Fisher

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President and Chief Executive Officer
Hastings Mutual Insurance Company

Brian N. Calley
President
Small Business Association of Michigan

James H. Fisher
Of Counsel, Dickinson Wright

Matthew R. Garber
Physician and Director of Hospitalist Program
Spectrum Health Pennock

Joan M. Heffelbower
Retired, Chief Financial Officer
Highpoint Community Bank

Barbara L. Hunt
Accounting Manager
Bethany Christian Services

Mark A. Kolanowski
President and Chief Executive Officer
Highpoint Community Bank

W. Scott McKeown
Retired Partner
McKeown & Kraai, PLC

Archie A. Warner
President and Chief Executive Officer
Harder and Warner Landscaping, Inc.
Harder and Warner Nursery, Inc.

OFFICERS

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President and Chief
Executive Officer

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Senior Vice President, Lending

Randoulph L. Teegardin
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Wealth Management

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Senior Vice President
and Chief Financial Officer

Khaja (Jay) Ahmed
Vice President, Credit Manager

Amanda M. Bechler-Currier
Vice President, Controller,
Compliance Officer

Jane M. DeBat
Vice President,
Retail Bank Services

Barbara L. Denny
Vice President, Retail Lending

Linda G. Engle
Vice President,
Business Development Director

Kimberly G. Finkbeiner
Vice President, Operations

Nancy A. Goodin
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Marketing Director

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Human Resources Director

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Business Development Officer

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Loan Operations Manager

Kristen D. Fisher
Senior Branch Manager, Middleville

Rebecca L. Gaylor
Cash Management Officer

Karla J. KruKo
Branch Manager, Wayland

Carol A. Svihl
Trust Officer

Valorie K. Vaughan
Branch Manager, Marshall

Locations

Highpoint Community Bank, a subsidiary of HCB Financial Corp., operates seven full-service banking offices.

1. Hastings
150 West Court Street
Hastings, MI 49058
269-945-2401
888-422-2280

2. Middleville
435 Arlington Street
Middleville, MI 49333
269-795-3338

3. Bellevue
111 East Capital Avenue
Bellevue, MI 49021
269-763-9418

4. Nashville
310 North Main Street
Nashville, MI 49073
517-852-0790

5. Caledonia
9265 Cherry Valley SE
Caledonia, MI 49316
616-891-0010

6. Wayland
156 West Superior Street
Wayland, MI 49348
269-792-6201

7. Marshall
124 West Michigan Avenue
Marshall, MI 49068
269-558-0994

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